

Illustration of the **Four Components of "Return on Investment"**

1 **Cash Flow**

This first and perhaps most obvious component is "cash flow" - rental income minus expenses - or how much cash ends up in your pocket.

84,930	+	Rental Income
32,737	-	Operating Expenses
36,396	-	Mortgage Payments
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15,797	=	Cash Flow
174,000	/	Downpayment + Closing Costs
9.1%	=	Return on Investment from Cash Flow

2 **Appreciation**

As the value of the property increases, your return on investment increases.

580,000	=	Acquisition Price
5%	*	First Year Appreciation
609,000	=	Value at the end of Year 1.
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29,000	=	Amount of Value Increase
174,000	/	Downpayment + Closing Costs
17%	=	Return on Investment from Appreciation

3 **Equity Build-Up**

6.85% 25 \$ 3,032.99

Even if the property did not increase in value, Equity will increase solely from paying down the mortgage.

435,000	=	Loan Amount at Closing
428,190	=	Loan Amount at the end of Year 1
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6,810	-	Equity Build-Up in Year 1
174,000	/	Downpayment + Closing Costs
3.9%	=	Return on Investment from Equity Build-Up

4 **Tax Benefits**

One pays less income taxes on a real estate investment than on other investment vehicles.

52,193	=	Cash Flow Before Loan Payments (rents less expenses)
16,433	-	Depreciation (assumes 15% land, 30 year recovery)
29,586	-	Mortgage Interest
6,173	=	Taxable Income Year 1
4,939		Less 20% Exclusion for LLC Ownership under new tax law
37%	*	Marginal Tax Rate
1,827.29	=	Federal Income Tax
1,827		Federal Income Tax
15,797	/	Cash Flow
11.6%	=	Effective Tax Rate on This Investment
5,845	=	Tax if Cash Flow came from a non-preferred investment vehicle
1,827	-	Tax from this preferred investment vehicle.
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4,018	=	Income Tax Savings
2.3%		Return on Investment from Tax Savings

Total / Summary

1:	15,797	Cash Flow
2:	29,000	Appreciation Year 1
3:	6,810	Equity Build Up Year 1
4:	4,018	Tax Savings Year 1
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	55,624	Total Return from this Investment
	174,000	Downpayment + Closing Costs
	32.0%	Total Return from this Investment

Illustration of Internal Rate of Return over a 10-Year Holding Period
3500 CALLAWAY AVENUE

Purchase Price	580,000	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
Annual Rent	4.0%	84,930	88,327	91,860	95,535	99,356	103,330	107,464	111,762	116,233	120,882
Vacancy	3.0%	2,548	2,650	2,756	2,866	2,981	3,100	3,224	3,353	3,487	3,626
Effective Income		82,382	85,677	89,104	92,669	96,375	100,230	104,240	108,409	112,746	117,255
Expenses	4.0%	32,737	34,047	35,408	36,825	38,298	39,830	41,423	43,080	44,803	46,595
Exp as a percent of Annual Rent		40%	40%	40%	40%	40%	40%	40%	40%	40%	40%
Exp per unit	6	5,456	5,674	5,901	6,137	6,383	6,638	6,904	7,180	7,467	7,766
NOI	0	49,645	51,631	53,696	55,844	58,078	60,401	62,817	65,330	67,943	70,660
Debt Service	\$ 3,033	36,396	36,396	36,396	36,396	36,396	36,396	36,396	36,396	36,396	36,396
Before Tax Cash Flow	(174,000)	13,249	15,235	17,300	19,448	21,682	24,005	26,421	28,934	31,547	430,846
17.3% Internal Rate of Return											
NOI		49,645	51,631	53,696	55,844	58,078	60,401	62,817	65,330	67,943	70,660
Less Interest		29,586	29,105	28,590	28,038	27,447	26,814	26,137	25,412	24,635	23,804
Less Depreciation		15,467	15,467	15,467	15,467	15,467	15,467	15,467	15,467	15,467	15,467
Taxable Income to Individuals		4,592	7,059	9,640	12,340	15,164	18,120	21,213	24,451	27,841	31,390
Pass Thru Entity	20%	(918)	(1,412)	(1,928)	(2,468)	(3,033)	(3,624)	(4,243)	(4,890)	(5,568)	(6,278)
Taxable Income	0	3,674	5,647	7,712	9,872	12,131	14,496	16,971	19,561	22,273	25,112
Tax @ *	37%	1,359	2,090	2,853	3,653	4,489	5,363	6,279	7,238	8,241	9,291
After Tax Cash Flow	(174,000)	11,890	13,145	14,447	15,796	17,193	18,641	20,142	21,696	23,306	359,184
14.2% Internal Rate of Return											
Purchase	580,000										
L-V	75%										120,882
Loan	435,000										6.5
Down Payment	145,000										784,245
Cap Improvement	-									6%	47,055
Closing Costs	29,000										425,333
Initial Investment	174,000										311,857
Rate	6.85%									20%	62,371
Term	25										340,608
P&I	\$3,032.99										396,582
											334,211
Mortgage Amortization		1	2	3	4	5	6	7	8	9	10
435,000 Beg Bal		435,000	428,190	420,900	413,093	404,735	395,786	386,204	375,945	364,961	353,200
6.85% Prin		6,810	7,291	7,806	8,358	8,949	9,582	10,259	10,984	11,761	12,592
25.0 Int		29,586	29,105	28,590	28,038	27,447	26,814	26,137	25,412	24,635	23,804
3,033 Bal EOY		428,190	420,900	413,093	404,735	395,786	386,204	375,945	364,961	353,200	340,608
Cost Recovery / Depreciation		580,000	580,000	Building	80%	464,000	Land	20%	116,000	Life	30
		15,467	15,467	15,467	15,467	15,467	15,467	15,467	15,467	15,467	15,467
Basis		564,533	549,067	533,600	518,133	502,667	487,200	471,733	456,267	440,800	425,333

* Tax rate of 35% applies to income of \$200,001 to \$500,000 for singles; \$400,001 to \$600,000 for married filing jointly. Marginal rate above \$500k/\$600k is 37%.